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Entertainment firms win file-sharing duel

By Jefferson Graham, USA TODAY

LOS ANGELES — Wayne Rosso knows his way around the online song- and movie-swapping jungle.

A former president of file-sharing company Grokster, he now runs Mashboxx, a company that proposes to take file sharing legitimate. His new service is expected to launch within days.

Even before Monday, traditional file sharing was in trouble, under intense legal and political pressure from the entertainment industry, Rosso says. "We knew the free ride couldn't go on forever," he says.

Winners and Losers in 'MGM v. Grokster'

Winners

- **Recording industry.** MGM, Walt Disney, Paramount and most other big record labels say illegal downloading hurt sales.
- **Popular musicians.** Sheryl Crow, Don Henley and other musicians say file sharing steals their hard work and threatens their livelihood.
- **Legal music-downloading sites.** Sites such as iTunes and Napster, which sell music online in partnership with record labels, may see a rise in sales if file-sharing sites shut down or users defect.

Losers

- **Grokster and StreamCast, operator of Morpheus.** The co-defendants could face huge fines for users' copyright violations.
- **Other file-sharing services.** Sites such as BitTorrent, which allows users to share video feeds, will come under increased scrutiny.
- **Little-known musicians.** File-sharing services helped some consumers discover little-known artists, especially those without backing from big record labels. That avenue will disappear if file sharing declines.
- **File sharers.** The court ruling could mean the end of most file-sharing sites based in the USA, though it will do little to those overseas.

Not yet clear

- **Tech industry.** Intel and other tech companies feared that a ruling against Grokster could set a dangerous precedent, holding all tech companies responsible for what users do with their products. Instead, the ruling was limited to sites that encourage and are used primarily for piracy — not what the industry had hoped, but better than it feared.

Source: USA TODAY research

But the Supreme Court ruling in *Metro-Goldwyn-Mayer v. Grokster*, the case pitting 28 entertainment companies against two tiny file-sharing companies, was its biggest blow yet.

The court unanimously sided with the entertainment companies in a surprising ruling that was much more definitive than expected. The court said Grokster and competitor StreamCast, which runs the Morpheus file-sharing site, could be held liable for their users' piracy. The reason: Grokster and Morpheus were used overwhelmingly to trade pirated music and movies, and even encouraged it.

The sites had argued that their activity was legal under *Sony v. Universal City Studios*, a 1984 Supreme Court case that said VCRs were legal, despite concerns that they could be used to pirate movies, because they had "substantial non-infringing uses." Tech companies argued that any deviation from the so-called Betamax decision would stifle innovation by making tech companies liable for anything their customers did with their products.

But the Supreme Court said the damage that file-sharing sites can cause is more significant than their non-infringing uses. That decision will have a huge impact on record companies, musicians, legal download sites, consumer

electronics and software makers — and every American who buys music, movies or other entertainment.

File sharing — also known as peer-to-peer, or P2P, networking — began in 1999 as an experiment in then-freshman Shawn Fanning's dorm room at Northeastern University. He devised a program — he called it Napster — to help students find MP3 digital music files more efficiently.

More swappers than ever

The program — and the onslaught of free online music — became a worldwide phenomenon as millions of young PC users stopped buying CDs when they found how easy it was to pluck songs from the celestial jukebox at the click of a mouse.

The music industry successfully pressed a shutdown of the original Napster, but more powerful copycats — Kazaa, eDonkey, LimeWire and BearShare — emerged.

File sharing has mushroomed.

The number of people using file-sharing programs such as Kazaa and eDonkey has more than doubled since July 2003, when the Recording Industry Association of America said it would begin filing copyright-infringement lawsuits against song swappers. Then, there were 3.4 million using file-sharing programs at any given time, a number that ballooned to 8.6 million by May, says Internet measurement company BigChampagne.

Excerpts from high court's decision

Excerpts from Justice David Souter, writing for the court in a unanimous decision that found file-sharing companies that encourage copyright infringement liable for damages:

- "One who distributes a device with the object of promoting its use to infringe copyright is liable for the resulting acts of infringement by third parties."
- "MGM's evidence gives reason to think that the vast majority of users' downloads are acts of infringement, and the probable scope of copyright infringement is staggering."
- "The record is replete with evidence that from the moment Grokster and StreamCast began to distribute their free software, each one clearly voiced the objective that recipients use it to download copyrighted works, and each took active steps to encourage infringement."
- "Digital distribution of copyrighted material threatens copyright holders as never before, because every copy is identical to the original, copying is easy, and many people (especially the young) use file-sharing software to download copyrighted works."
- "As the account of the facts indicates, there is evidence of infringement on a gigantic scale."

CD sales have taken a huge hit, falling to 766 million CDs in 2004 from 942 million in 2000, according to the RIAA. CD sales are down 7% this year.

RIAA CEO Mitch Bainwol calls the ruling "an important pivotal point" that will see "the emergence of a legal marketplace."

He says he does not expect file sharing to disappear: "Our goal is to get it to reasonable levels."

The powerful recording industry trade group has filed lawsuits against nearly 12,000 consumers since September 2003. Last year, the Motion Picture Association of America began suing online movie swappers.

The technology industry's opinion on the ruling was divided. Some organizations, such as tech trade group Information Technology Association of America, praised it because the court didn't say that all tech companies could be liable for what users do with their products.

Others complained that the ruling was too ambiguous. Gary Shapiro, CEO of the Consumer Electronics Association, fretted that the ruling could lead to "massive uncertainty and the likelihood of massive legal bills. The court has done little to provide a clear path for legitimate innovators and manufacturers to avoid lawsuits," he said in a statement.

Chipmaker Intel, which filed legal documents in support of Grokster, said the ruling was so ambiguous that the company didn't have an immediate reaction. "We are pleased that the court did not overturn the Sony Betamax standard," spokeswoman Jennifer Greeson said. "We just need more time to understand the specific language of the ruling and to consider the implications."

A boost for pay services

Monday's decision was a big shot in the arm for CEO Rob Glaser's company, RealNetworks. It sells digital singles for 89 cents apiece at its RealPlayer Music Store and Rhapsody music service. "Basically, the court, on the day they made their Ten Commandments decision, has ruled that thou shall not steal," he says. "We agree."

He says companies like Real have focused on the over-25 consumer, because teens and young adults — the heaviest users of P2P — have been tougher to crack. With the court's decision, "We'll be able to make some inroads, finally."

Apple's iTunes is the most popular pay site. Yahoo, MSN and America Online also are competing for online music dollars.

Former Grokster president Rosso, who used to make headlines for snarling with the RIAA, is working with Napster founder Fanning in launching his legit Mashboxx.

The service, which uses Fanning's filtering technology Snocap, will automatically detect an unauthorized file and replace it with an offer for the consumer to buy the song. Users will still get to trade authorized songs and make recommendations to each other. "Our model is the future," he says.

The P2P field

While Morpheus and Grokster look to another day in court, Washington, D.C., attorney Elizabeth Cohen says they're going to have a tough time of it.

"I don't see how they could come out with a win," she says. "The court has to apply the test the Supreme Court told them to apply, and Grokster and Morpheus can't pass that."

The Supreme Court decision says an entity can be liable if it actively encourages users to engage in piracy or other illegal activities.

It also seems to separate a company's conduct from the technology itself, although how that might play out is fuzzy.

If a P2P software company were found to have illegally encouraged users to make pirated copies, courts might decide only to force the company to stop the encouraging activities — and leave the technology intact.

So on one hand, that could protect the technology companies. On the other, it could mean that a single ad — such as Apple Computer's old "Rip, Mix, Burn" campaign — would be enough to launch a lawsuit by copyright holders.

"This may mean that technologists are going to have to defend their conduct, which has not before now been put under a microscope," digital music lawyer Andrew Bridges says.

If that all seems uncertain, that's because it is. "This is a complex decision that in some respects is half-baked," says Bridges. Further rulings in lower courts "will continue to bake it."

Sam Yagan, who runs the popular eDonkey file-sharing company in New York, said he was "disappointed" with the ruling but didn't think it meant the end of his business. "As long as you've been a good citizen and haven't directed your users to induce, I think you're fine," he says.

The creators of BitTorrent — a file-trading service favored by movie swappers — also don't see Monday's ruling as a door closer.

"The court is not ruling against P2P or technology generally," says Ashwin Navin, BitTorrent's COO. "They're ruling against people who hide behind the front of technology in court but solicit users to break the law in practice."

Gene Munster, an analyst at equity firm Piper Jaffray, thinks most people will acquire new music via download in 10 years, and that puts companies such as Real, the reconstituted Napster and Apple in a good position, he says. "The early movers have an advantage."

Contributing: Kevin Maney in McLean, Va., and Michelle Kessler in San Francisco. Graham reported from Los Angeles.

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